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SIPDIS

TREASURY FOR INTERNATIONAL AFFAIRS - CPLANTIER AND MMILLS
NSC FOR BRYZA AND MCKIBBEN

SENSITIVE

E.O. 12958: N/A
TAGS: EFIN ECON TU IMF
SUBJECT: POSSIBLE DELAYS IN IMF REVIEW

Ref: Ankara 3033

1.(SBU) Summary: The first review under Turkey's new IMF program may run into delays, as the GOT struggles to get the social security and banking reform laws through parliament before summer recess. The only substantive disagreement is on other legislation providing favorable repayment terms for social security arrears. On State Bank privatization, the GOT and IFI's are looking to move more quickly than originally foreseen by the program. End Summary.

Social Security and Banking Reform Legislation Held Up:
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2.(SBU) Turkish Treasury Undersecretary Canakci and IMF Deputy Resrep separately confirmed press reports of possible delays in IMF approval of the first review under the recently-approved $10 billion Standby Arrangement. Passage of two major pieces of legislation -- the banking reform law and the pension reform law -- are "structural performance criterion" for the first review. Parliamentary approval of these two laws looks increasingly problematic by July 1,when the legislature is due to go on summer recess. The Deputy Resrep explained that, despite GOT efforts -- including by Prime Minister Erdogan -- to push through the legislation as quickly as possible, the process is slow. Both laws are long and complicated and normal legislative procedure requires parliament to go through them article by article. The Deputy Resrep said the GOT may try to work out an expedited procedure, or keep the parliament in session past July 1, as it did both last year and the year before. For now, both the Deputy Resrep and Canakci said that parliament is working flat out, having worked through the weekend, for example. The Deputy Resrep did not seem overly concerned about the delay, noting that the timetable built into the program was tight and recognizing there was no substantive problem. From the standpoint of GOT finances, he agreed there was no urgency about the disbursement. On the other hand, if the review is delayed too long, it will throw off the schedule of reviews and disbursements foreseen under the program.

Sustantive Differences over Social Security Premia:
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¶3. (SBU) Unlike the banking and pension reform legislation -- the draft law on public receivables, which provides concessions for late payments of social security premia -- does involve substantive differences between the IMF and the GOT. As reported in reftel, objectionable clauses remain despite the GOT having backed off and dropped some of the provisions that the IMF found most objectionable. The Deputy Resrep said that a version with these objectionable bits had been approved in committee and was before the general assembly. He explained that the IMF mission currently in Ankara was trying to convince the GOT to put aside the legislation and work with the IMF over a longer period to take a more comprehensive look at the set of issues associated with arrears to the social security institutions. The IMF would send out a technical team focused just on these issues. He elaborated that most of the arrears--YTL 21 billion (about $15.4 billion)--are at Bag-Kur (the social security institution for the self-employed) and it is impossible to know how much of this amount represents real arrears and how much is simply due to poor-record-keeping. He added that there was another YTL 6 billion ($4.4 billion) at the main social security institution (for non-civil servant employees). The problem facing the GOT is the political embarrassment of being seen to withdraw the legislation under IMF pressure.

State Bank Privatization Accelerated?

4.(SBU) The other key structural reform ("structural benchmark") before the IMF will agree to a Letter of Intent and go to a board vote, is GOT approval of a revised

strategy to privatize the State Banks. Both Canakci and the Deputy Resrep said that the World Bank, which has the lead on this issue, is moving with the GOT economic technocrats in an unexpected direction. Instead of merely agreeing on a strategy, as required under the program, the IFI's and the GOT might agree to hire a privatization advisor very quickly and to more much faster than originally planned towards privatization. The privatization advisor would be an international investment bank which would be compensated largely on the basis of the proceeds of sales of assets or shares from the state banks. The Deputy Resrep confirmed that the privatization process would be handled by Turkish Treasury, and not by the Privatization Administration (which has a poor track record with large privatizations). Canakci said the strategy only needed to be adopted by the state bank boards and by Minister Babacan, though he left the door open to eventual Council of Ministers approval.

5.(SBU) The Deputy Resrep said that there had recently been a notable shift in GOT and IFI thinking about how quickly the state banks could move towards privatization. Both had long thought privatization would take several years due to the need to find a solution prior to privatization for the massive portfolios of government securities on the banks' balance sheets. Neither the IFI's nor the GOT thought it likely there would be a market for these banks as long as they held so many government securities, and there were concerns about the market impact if these securities were added to the supply of traded government debt. However, given the recent surge both in purchases of government securities and in foreign bank interest in acquiring Turkish financial institutions, the IFI's and GOT now believe there may be a market for these banks, whether in whole or broken up in pieces. Canakci thought the current climate was right to move ahead.

But No Macro Issues:

¶6. (SBU) As for the program's macroeconomic (as opposed to structural) targets, Canakci pointed out that Turkey seemed to be meeting all its fiscal and monetary policy projections and targets. Not wanting to appear complacent, Canakci insisted they were carefully monitoring fiscal performance. The only yearend macro projection which may need a slight adjustment was the current account deficit which looks to come out slightly larger than projected. Aside from adjusting the projection, however, Canakci pointed out that the IMF mission had not raised the risk associated with the current account deficit this time, which he took to mean the IMF was not overly concerned. Canakci said the composition of the financial account seems to be improving (presumably he meant increased FDI).

Timing/Next Steps:

7.(SBU) Going forward, the Deputy Resrep expected the mission to go over the state of play with Minister Babacan -- who was in the U.S. the week of June 6-10 -- and then the IMF would decide whether to stay longer in hopes of reaching agreement, or to return to Washington without a signed LOI, leaving the GOT with a list of needed actions.

Comment:

¶8. (SBU) There was a glass half-full/glass half-empty quality to these two conversations. U/S Canakci expressed pleasure that there was only one substantive disagreement (over the social security arrears) and no need for waivers. The Deputy Resrep lamented that the IMF staff spend 90 percent of their time on damage control and only 10 percent on thinking about what reforms Turkey needs and how to implement them.